



National Audit Office

**REPORT BY THE
COMPTROLLER AND
AUDITOR GENERAL**

HC 1464

SESSION 2010–2012

14 SEPTEMBER 2011

Means Testing

Key facts

£87bn

Spending on means-tested benefits in 2009-10

42m

Means-tested benefit claims in payment in 2009-10

1.2m

Cases related to means-tested benefits addressed by Citizens Advice Bureaux in 2009-10

- 13 per cent** Spending on means-tested benefits as a share of total public spending in 2009-10
- 34 per cent** Means-tested benefit payments as share of net income of poorest fifth of households
- £46 billion** Spending on benefits which may be passported from means-tested benefits in 2009-10
- £9 billion** Total overpayments of tax credits between 2003-04 and 2009-10, due to changes in claimant circumstances
- £47** Average annual cost of maintaining an existing claim for means-tested Pension Credit, compared to £14 for an existing State Pension claim
- 152** Local authorities who can decide the conditions for eligibility for state support for adult social care in England

Summary

1 Means testing helps to target state support at people with low incomes, savings or other financial resources. In 2009-10, the Government spent £87 billion on means-tested benefits, 13 per cent of total public expenditure. There were 42 million means-tested benefit claims in payment in 2009-10, and the poorest fifth of families relied on means-tested programmes for, on average, 34 per cent of household net income.

2 Means testing is applied to many areas of public spending beyond cash benefits. Eligibility for free or subsidised goods or services, such as medical prescriptions and social housing, is often determined partly or entirely through a means test. We therefore interpret benefits broadly to include cash, services and transfers in kind.

3 The main alternatives to means testing are:

- universal provision, such as the National Health Service; and
- contribution-based schemes, such as the State Second Pension, where recipients receive benefits related to contributions they have made.

4 The Government has announced major reforms to means-tested benefits. These include replacing many benefits for those of working age with the new means-tested Universal Credit from 2013. Other proposed changes will affect the extent of means testing. For instance, reforms to the State Pension should reduce reliance on means-tested Pension Credit. On the other hand, from 2013, Child Benefit will no longer be a universal benefit, as families with higher-rate taxpayers will be ineligible. It is clear that means testing will continue to be used extensively for the foreseeable future. Assessing Universal Credit and other proposals is not within the scope of this report.

5 The purpose of this report is to identify the risks to value for money that arise from the design of means tests. The policy decision to apply a means test can lead to more effective targeting of spending than under universal or contributory schemes. But it has important consequences, including for administrative costs, work incentives and benefit take-up. We find that the design and implementation of means tests is key to mitigating risks to value for money.

Why does means testing matter?

6 The UK depends heavily on means testing to concentrate support on those in need while limiting overall spending. Greater reliance on universal or contributory benefits would require either large increases in spending or reductions in the level of support provided to many people. For example, average Working Tax Credit awards were £3,173 per claimant in 2009-10. Providing this amount universally across the working-age population would cost £122 billion, more than 16 times current expenditure.

7 While means testing can be an effective way to target spending, there are unavoidable consequences for the costs and effectiveness of benefit programmes. Means testing creates important trade-offs, particularly between preserving incentives to work and save, targeting benefit payments and managing the costs of delivering benefits.

- Means testing affects incentives to work and save. Means-tested support is withdrawn as income and assets increase, so some claimants see little financial return to working more. The Institute for Fiscal Studies estimated that in 2010, 2.6 per cent of workers, or about 700,000 people, would receive less than 10p for each extra £1 they earned.
- Means testing causes additional costs of administering and delivering benefits. The complexity of means testing compared to, say, universal provision, is associated with higher administrative costs and increased fraud and error. Means testing can also impose burdens on claimants and those who help them. Citizens Advice Bureaux dealt with 1.2 million cases related to means-tested benefits in 2009-10, 17 per cent of their total caseload.
- Means-tested programmes interact in a more complex way than universal or contributory benefits. Claimants often depend on multiple benefits that might be withdrawn at the same time, leading to large and sudden changes to claimants' income and strong disincentives to work. This applies not only to the major benefits administered by the Department for Work and Pensions and HM Revenue & Customs, but also to many other benefits that depend on these for their eligibility (sometimes called 'passporting'), including free school meals and Cold Weather Payments.

8 Effective implementation and design can address many of the adverse consequences of means testing. In previous reports, we found that departments have faced major challenges in implementing means-tested benefit programmes. They have struggled to streamline administration, prevent fraud and error, increase take-up of benefits, target support and reduce complexity. Better implementation remains central to ensuring that departments can achieve value for money in means testing.

9 In this report, we focus on the design of means-tested benefits. Design choices, such as the type of means to include in the test, are complex and often poorly understood. Serious risks to value for money can result if departments fail to take account of how different design choices affect outcomes and costs across government. Departments can act in several ways to ensure that the costs of means testing are managed and predicted, and to balance effectively the benefits of means testing in reducing public spending against these costs. The three areas we consider are:

- identifying the impacts of means testing, and understanding trade-offs between different impacts (Part Two);
- making choices about how to design means tests and learning from past experiences (Part Three); and
- coordinating means tests between departments (Part Four).

Key findings

10 Departments do not systematically consider or measure all of the impacts of means testing, particularly the burden on claimants. Understanding these impacts is critical to informing policy decisions and programme design related to means testing. We found that departments were aware of many of the impacts of means testing, but this knowledge was not always used effectively. We reviewed a selection of departmental Impact Assessments published before major reforms, and found that the range of impacts included varied substantially. In particular, most of the Impact Assessments failed to assess the burdens on claimants, such as the costs of completing forms and requesting advice.

11 Departments need to take account of past lessons when designing means-tested benefits. Departments have learned from past difficulties with means testing, for example, in the management of overpayments of tax credits, but this learning has often been expensive and slow. Tax credit overpayments due to changes in claimant circumstances totalled over £9 billion between 2003-04 and 2009-10. In many cases, HM Revenue & Customs has found it difficult to claw this money back at the end of the tax year. These overpayments have arisen because the legislation determines provisional awards on the basis of the claimant's income in the previous year, and on the basis of other circumstances, which are liable to change. Despite changes to the design of tax credits, overpayments remain a substantial feature of the system. It is important that government as a whole learns from such experiences, both in designing benefits and understanding how to cope with the consequences of design choices.

12 There is no overall accountability for interactions across programmes administered by different departments. Departments are responsible for the effects of the programmes they administer, including indirect and wider impacts, but the interactions between programmes that result from means testing make broader coordination important. In some areas, departments work together to assess interactions. For instance, the Child Poverty Unit works with the Department for Work and Pensions, the Department for Education and HM Treasury to look at how benefits such as free school meals affect child poverty. However, there is no overall responsibility for looking at the wider system of means testing, such as how work incentives are affected by higher education funding or the overall effects on claimants of multiple benefits.

Tackling the risks of means testing

13 In an environment of major reform, it will be difficult to achieve value for money unless all departments responsible for means-tested benefits understand the impacts of means testing, learn from past experience and coordinate between benefits. We make several suggestions for departments that could help to mitigate the risks.

- a The impacts of means testing are not fully considered in the assessment of proposed reforms.** Departments could:
- include in their Impact Assessments all relevant impacts of means testing, for example the burden on claimants and the effect this has on incentives and take-up;
 - quantify systematically the extent of these impacts and be transparent about trade-offs between objectives; and
 - share best practice in using costing models to understand the incremental impact of design choices on administration costs.
- b Learning from past experience across government needs to be embedded in programme design and implementation.** Departments could:
- develop a common framework for understanding and explaining choices about the design of means tests, as in **Figure 1**, to enable policymakers to make informed decisions about means-tested benefits;
 - revisit design choices regularly as part of the evaluation and appraisal process; and
 - collect and share information about how design choices affect outcomes for departmental spending, incentives and the burden on individuals.

Figure 1
Options in designing a means test

	← Simpler		More complex →
Whose means are taken into account?	Individual only	Household or family based on formal relationships (e.g. parenthood)	Household or family based on informal relationships (e.g. living together)
Which means are considered?	Employment income	Employment income and capital	Disposable income (e.g. after housing or childcare costs)
Where does information come from?	Passported from other benefits	Based on an established system	Separate verification of declaration of means
How are benefits withdrawn?	Simple threshold	Smooth taper of individual benefit	Taper combined with other benefits payments
How are changes in circumstances considered?	Long fixed assessment periods, no clawback	Periodic review, retrospective clawback	Self-reported changes in circumstances as they happen

Source: National Audit Office analysis

c There is little coordination of interactions between benefits administered by different departments.

- Collectively, departments have developed substantial expertise in designing and administering means-tested benefits. However, this expertise is dispersed across government, and can be difficult for individual departments to access. The Department for Work and Pensions or a central department such as HM Treasury could support better coordination and information sharing. This could include providing guidance on the impacts that a department should consider and the sources of expertise about them. Departments could work together to ensure that existing policy simulation analysis is available across government and reflected in policy design.
- Departments could increase assessment of wider impacts when developing policy reforms, clearly identify the risks of interactions that might undermine policy objectives and adjust for these risks in options appraisal.
- As part of its existing role in managing spending risks, HM Treasury could ensure that departments have systematically considered the impacts of means testing across government when changing or developing means-tested benefits.